



**U.S. Department of the Interior
Office of Inspector General**

AUDIT REPORT

**OFFICE OF SURFACE MINING RECLAMATION
AND ENFORCEMENT FINANCIAL CONTROLS
OVER THE TECHNICAL ASSISTANCE AGREEMENT
WITH THE REPUBLIC OF INDONESIA**

**REPORT NO. 97-I-165
DECEMBER 1996**



United States Department of the Interior

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20240

DEC 18 1998

MEMORANDUM

TO:

The Secretary

FROM:

Wilma A. Lewis
Inspector General

SUBJECT SUMMARY: Final Audit Report for Your Information - "Office of Surface Mining Reclamation and Enforcement Financial Controls Over the Technical Assistance Agreement With the Republic of Indonesia" (No. 97-I-165)

Attached for your information is a copy of the subject final audit report. The objective of the audit was to determine whether the Office of Surface Mining Reclamation and Enforcement had established and implemented adequate controls to ensure compliance with the financial management, accounting, and reporting requirements of the grant agreement with the Bureau of Environment and Technology of the Ministry of Mines and Energy, Republic of Indonesia.

We found that, overall, Surface Mining's internal controls were adequate to ensure that the accounting records on direct costs were accurate, properly supported, and in accordance with the terms of the technical assistance agreement with the Republic of Indonesia. However, we concluded that Surface Mining needed to strengthen its internal controls over the preparation of the quarterly financial reports and the computation of overhead costs. We recommended that Surface Mining establish and implement procedures to ensure that: (1) administrative overhead amounts are recorded and computed accurately; (2) direct and overhead costs included in the quarterly reports are reconciled to accounting system data; and (3) program staff comply with provisions for the calculation of overhead costs and the preparation of the quarterly reports.

Surface Mining concurred with the report's three recommendations, which will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

If you have any questions concerning this matter, please contact me at (202) 208-5745 or Mr. Robert J. Williams, Acting Assistant Inspector General for Audits, at (202) 208-4252.

Attachment



United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

DEC - 3 1996

AUDIT REPORT

Memorandum

To: Director, Office of Surface Mining Reclamation and Enforcement

From: Robert J. Williams *Robert J. Williams*
Acting Assistant Inspector General for Audits

Subject: Audit Report on Office of Surface Mining Reclamation and Enforcement
Financial Controls Over the Technical Assistance Agreement With the Republic
of Indonesia (No. 97-I-165)

INTRODUCTION

This report presents the results of our limited review of the Office of Surface Mining Reclamation and Enforcement's financial management, accounting, and reporting controls for funds received under its technical assistance agreement with the Bureau of Environment and Technology of the Ministry of Mines and Energy, Republic of Indonesia. The objective of the review, which was initiated in response to a February 6, 1996, request from Surface Mining's Deputy Director, was to determine whether Surface Mining had established and implemented adequate controls to ensure compliance with the financial management, accounting, and reporting requirements of the agreement.

BACKGROUND

In February 1995, the Office of Surface Mining Reclamation and Enforcement entered into a \$3.2 million reimbursable agreement with the Bureau of Environment and Technology of the Ministry of Mines and Energy, Republic of Indonesia, for a project to provide technical assistance to the Republic to develop, establish, and implement policy, regulations, and guidelines to control environmental effects caused by mining activities in Indonesia. The project is being funded by a portion of a \$260.5 million loan to the Republic from the International Bank for Reconstruction and Development.

The agreement stipulates that the Republic provide periodic advance payments to Surface Mining to cover necessary and agreed-to project expenditures. Specifically, Surface Mining is to be reimbursed for all direct costs of the services provided and for administrative costs

based on a fixed rate of 22.5 percent of the direct costs, excluding certain equipment items identified in the agreement. In addition, the agreement states that the Assisting Agency is to “keep accurate and systematic accounts and records . . . in such form and detail as will clearly identify all relevant time charges and cost, and the bases thereof. ” Further, the agreement requires Surface Mining to submit to the Republic and the Bank quarterly reports that include itemized project expenditures for the previous quarter and an itemized estimate of additional funds requested.

Surface Mining’s responsibility for the project is specified as follows: (1) its resident Project Director in Indonesia has overall field administrative responsibility; (2) its Finance Center staff in Denver, Colorado, accounts for project costs and funds received; and (3) the program staff in the headquarters office in Washington, D. C., provides overall project coordination.

SCOPE OF AUDIT

Our audit addressed Surface Mining’s internal controls established and implemented to ensure compliance with the agreement’s financial management, accounting, and reporting requirements from inception of the agreement (February 1995) through December 31, 1995. To determine the adequacy of the internal controls, we reviewed accounting and billing reports, quarterly reports, supporting documentation for the receipt and disbursement of funds, calculations and composition of overhead charges, documentation flow, and the system for preparing selected accounting and financial reports. Since Surface Mining requested that our audit focus on a review of controls over project costs, we did not verify: (1) the accuracy of Surface Mining’s overhead rate of 22.5 percent because it was established as a fixed rate by the agreement and (2) estimates of its additional funding requirements that were included in the quarterly reports. The review was performed at Surface Mining’s headquarters office in Washington, D.C. In addition, we contacted Surface Mining’s Finance Center in Denver and the Project Director in the Republic of Indonesia regarding specific accounting and reporting issues.

Although we evaluated the effectiveness of Surface Mining’s financial management, accounting, and reporting internal control structure over the agreement and tested Surface Mining’s compliance with certain provisions of the agreement, it should be noted that because of inherent limitations in any system of internal controls, losses, noncompliance, or misstatements may occur and not be detected.

PRIOR AUDIT COVERAGE

Neither the Office of Inspector General nor the General Accounting Office has issued any reports within the past 5 years concerning Surface Mining’s financial management, accounting, and reporting internal controls related to its agreement with the Bureau of Environment and Technology of the Ministry of Mines and Energy. However, the Office of

Inspector General has issued five reports during this period on Surface Mining's financial statements, as required by the Chief Financial Officers Act of 1990. The most recent report, "Office of Surface Mining Reclamation and Enforcement Financial Statements for Fiscal Years 1994 and 1995" (No. 96-1-400), issued in February 1996, stated:

Surface Mining's internal control structure in effect on September 30, 1995, was sufficient to safeguard assets against loss from unauthorized use or disposition; ensure that transactions were executed in accordance with laws and regulations; ensure that transactions were properly recorded, processed, and summarized; and provide reasonable assurance that any losses, noncompliance, or misstatements that are material to the financial statements would be detected.

The four prior reports contained similar conclusions regarding Surface Mining's internal control structure.

RESULTS OF AUDIT

We found that, overall, the Office of Surface Mining Reclamation and Enforcement's internal controls were adequate to ensure that the direct project costs recorded in the accounting records were accurate, properly supported, and in accordance with the terms of the technical assistance agreement with the Republic of Indonesia. However, we concluded that Surface Mining needs to strengthen its internal controls over preparation of the quarterly financial reports and the computation of overhead costs to ensure that: (1) costs reported in the quarterly reports submitted to the Republic and the International Bank for Reconstruction and Development agree with the costs recorded in the accounting records and (2) administrative overhead costs are properly computed and accurately recorded. In addition, we concluded that Surface Mining needs to improve coordination between the Project Director and other program staff in the Denver Finance Center and the Washington headquarters office to ensure timely identification and resolution of issues related to the agreement's financial management, accounting, and reporting requirements.

The agreement (Appendix B and part 6.5(c)) requires Surface Mining to submit, to the Republic and the Bank, quarterly reports that include itemized project expenditures for the previous quarter. In addition, the agreement (part 3 .5) states that the Assisting Agency is to "keep accurate and systematic accounts and records . . . in such form and detail as will clearly identify all relevant time charges and cost, and the bases thereof. " We found, however, that Surface Mining did not have adequate controls to ensure that costs recorded in the billing statements agreed with costs in the quarterly reports. As a result, the expenditures and unexpended obligations included in the quarterly reports prepared by the Project Director and provided to the Republic and the Bank for the periods ending September 30 (the first report submitted) and December 31, 1995, did not fully agree with the

corresponding amounts included in the project billing statements prepared by the Finance Center for the respective time periods. This information is summarized as follows:

| | <u>September 30, 1995</u> | | | <u>December 31, 1995</u> | | |
|--------------|-----------------------------|------------------------------|-------------------|-----------------------------|------------------------------|-------------------|
| | <u>Quarterly Report</u> | <u>Billing Statement</u> | <u>Difference</u> | <u>Quarterly Report</u> | <u>Billing Statement</u> | <u>Difference</u> |
| Expenditures | \$354,160 | \$448,575 | (\$94,415) | Not Reported | \$942,328 | N/A |
| Obligations | \$791,207 | \$669,757 | \$121,450 | \$1,082,949 | \$1,125,273 | (\$42,324) |

The Project Director could not provide a complete reconciliation of the variances between the quarterly reports and the billing statements. The Project Director said that these variances occurred, in part, because he had used the information available at the Indonesia Project Office in preparing the quarterly reports “because of the long delay [in] getting accounting data from Denver at the beginning of the project. ”

We also found that Surface Mining could not support its calculation of administrative overhead costs. The technical assistance agreement provides for Surface Mining to be reimbursed for its administrative overhead costs based on a fixed rate of 22.5 percent of direct costs, excluding certain equipment items. We found, however, that Surface Mining did not have adequate controls to ensure that the fixed rate was properly applied to the appropriate direct cost base. According to the program staff in the headquarters office that is responsible for overseeing the receipt and disbursement of funds and billing statement information, the overhead costs included in the billing statements were computed by the Project Director in Indonesia. However, neither the Project Director nor the Washington headquarters and Denver Finance Center program staff were able to provide adequate information in support of Surface Mining’s overhead calculation. For example, Surface Mining was unable to specifically explain how the overhead amounts included in the billing statements for the periods ending September 30 and December 31, 1995, were calculated, including what equipment items and costs were excluded from the direct cost base before applying the 22.5 percent overhead rate. Furthermore, the amount included in the billing statement at September 30, 1995 (\$104,127), did not agree with the amount reported by the Project Director (\$67, 143) in his quarterly report to the Republic for the same period. We could not analyze the difference between the quarterly report and the accounting billing statement at December 31, 1995, because the quarterly report did not include amounts expended during the quarter.

We concluded that these conditions existed because Surface Mining had not required the Project Director to submit the quarterly reports, including documentation supporting adjustments to recorded costs and overhead calculations, to Surface Mining’s Washington headquarters office or to the Denver Finance Center for review to ensure that the reported costs were accurate and adequately supported and to ensure that administrative overhead was

properly computed and recorded. We also believe that a contributing factor to this situation was that Surface Mining program officials did not fully understand the agreement's overhead calculation process. Consequently, there was minimal assurance that direct and overhead costs reported in the quarterly reports were accurate and supported.

Recommendations

We recommend that the Director, Office of Surface Mining Reclamation and Enforcement, establish and implement procedures to ensure that:

1. Administrative overhead amounts recorded in the accounting billing statements are computed accurately.
2. Direct and overhead costs included in the quarterly reports are reconciled to information in the accounting billing statement and the official accounting system and reviewed by either headquarters or Finance Center staff before the quarterly reports are provided to the Republic of Indonesia and the International Bank for Reconstruction and Development.
3. All program staff comply with the terms and conditions of the technical assistance agreement pertaining to the calculation of administrative overhead costs and preparation of the quarterly reports.

Office of Surface Mining Reclamation and Enforcement Response and Office of Inspector General Reply

The October 21, 1996, response (Appendix 1) to our draft report from the Acting Director, Office of Surface Mining Reclamation and Enforcement, concurred with all three recommendations and identified controls and procedures that are sufficient to ensure compliance with the financial management, accounting, and reporting requirements of the agreements. Based on the response, we consider the three recommendations resolved but not implemented. Accordingly, the unimplemented recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation, and no further response to the Office of Inspector General is required (see Appendix 2).

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, the monetary impact of audit findings, actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the cooperation of Surface Mining personnel in the conduct of our audit.



IN REPLY REFER TO:

United States Department of the Interior

OFFICE OF SURFACE MINING
Reclamation and Enforcement
Washington, D.C. 20240
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Memorandum

To: Acting Assistant Inspector General for Audits

From: Acting Director *Katharine L. Henry*

Subject: Response to Draft Audit Report on Office of Surface Mining
Reclamation and Enforcement Financial Controls Over the Technical
Assistance Agreement with the Republic of Indonesia (Assignment
No. E-IN-OSM-011-96)

This is in response to your September 19, 1996 memorandum and draft audit report entitled "Office of Surface Mining Reclamation and Enforcement Financial Controls Over the Technical Assistance Agreement with the Republic of Indonesia" (Assignment No. E-IN-OSM-011-96). We appreciate the opportunity to review the draft audit report and to provide our comments.

We have completed our review and concur with the report's findings and recommendations. Our specific plans for implementing your recommendations are explained in the attachment. The Assistant Director for Program Support and the Assistant Director for Finance and Administration will be the responsible officials for carrying out the implementation plan.

I would like to point out that OSM has recently realized the benefits of the audit exercise. Our end-of-year budget review for Fiscal Year 1996 indicated a potential source of confusion regarding reimbursable accounts and highlighted a need to clearly distinguish reimbursable funds from appropriated funds for purposes of budgetary decision making. In order to eliminate possible confusion, a separate configuration for displaying funding for the Indonesia project has been developed by our Office of Strategic Planning and Budget. This will allow the funds to be clearly separated for budget planning purposes.

On a related follow up matter, because of the need to ensure that OSM spends no more than the funds allocated under the technical assistance agreement, we would request your assistance in undertaking another review prior to the conclusion of the program.

This review should rescheduled so that sufficient time is available to OSM to make any necessary changes in controls or procedures. The project is currently scheduled to end on May 1, 1998.

The Indonesian Ministry of Finance, which will have lead responsibility for any final review, must supply a final accounting to the World Bank within six months of the end of the Indonesian Fiscal Year in which the project ends. The Indonesian fiscal year begins in April, so the Ministry of Finance must complete its review within six months of the close of the Fiscal Year which begins in April 1998 and ends in April 1999. Any additional Inspector General Review should comport with this time frame.

Please contact George Stone, Audit Coordinator, Office of Strategic Planning and Budget, at (202) 208-7840 if you have any questions concerning our response and to coordinate the scheduling of subsequent audits of the technical assistance agreements.

Attachment

cc: Assistant Secretary - Land and Minerals Management

**Planned Action on Recommendations in OIG Draft Audit Report on
Office of Surface Mining Reclamation and Enforcement Financial Controls
Over the Technical Assistance Agreement
With the Republic of Indonesia
(Assignment No. E-IN-OSM-011-96)**

The table below reflects the actions planned to implement the recommendations and a projected target date for completion of those actions. The officials responsible for plan implementation are the Assistant Director for Program Support (PS), and the Assistant Director for Finance and Administration (FA).

| Recommendation | Planned Action | Projected Completion Date | Action Official |
|--|---|---------------------------|-----------------|
| Administrative overhead amounts recorded in the accounting billing statements are computed accurately. | Apply controls to ensure that the fixed rate is properly applied to the appropriate direct cost basis and is supported by the official accounting records. | 12/31 /96 | AD/PS |
| Direct and overhead costs included in the quarterly reports are reconciled to information in the accounting billing statement and the official accounting system and reviewed by either headquarters or Finance Center staff before the quarterly reports are provided to the Republic of Indonesia and the International Bank for Reconstruction and Development. | Institute procedures to ensure that all future financial information used in the Quarterly Report is reviewed by appropriate Headquarters and Finance Center officials. | 12/31/96 | AD/PS |

| | | | |
|--|---|-----------------|------------------------|
| All program staff comply with the terms and conditions of the technical assistance agreement pertaining to the calculation of administrative overhead costs and preparation of the quarterly reports. | Develop a joint internal memorandum which: (1) establishes written guidance for calculation of administrative overhead and; (2) provides a process that ensures that program staff are informed of the terms and conditions of administrative overhead calculation and preparation of Quarterly Reports. | 12/31/96 | AD/PS AD/FA |
|--|---|-----------------|------------------------|

STATUS OF AUDIT REPORT RECOMMENDATIONS

| Finding/Recommendation Reference | Status | Action Required |
|-------------------------------------|------------------------------|---|
| 1, 2, and 3 | Resolved; not implemented | No further response to the Office of Inspector General is required. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation. |

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